

A paradigm shift to a new strategy for small island economies: Embracing demand side economics for value enhancement and long term economic stability

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Abstract

The article answers three interrelated questions pertaining to small island economies and tourism development under the condition of globalization: (1) why is tourism relevant for small island economies; (2) why is a supply perspective inappropriate for these economies; and (3) why is a demand perspective more appropriate for small island economies in the era of globalization? Empirical realities indicate that small islands have performed well in specializing as tourist destinations, despite their size constraints and resulting disadvantage in economic terms. The Caribbean region is an appropriate proxy for small island economies. However, globalization may be taking its toll on sectoral specialization in the Caribbean as a development strategy. The supply side strategy seems to have lost its effectiveness. To reverse this trend, the study proposes the implementation of new tourism strategies based on a demand focused approach to sustain value enhancement. These strategies have important managerial and policy implications.

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1. Introduction

The rationale for tourism as a development strategy derives from the link between exports and economic growth. Mihalič (2002) cited advantages of tourism compared with the export of goods and services: (1) natural, cultural or social attractiveness, which normally cannot be exchanged, and thus can be valorized at a premium through tourism; (2) products produced locally can command a higher price sold locally to tourists than when exported and have lower costs because of no or lower transportation costs or insurance costs; and (3) some perishable goods (e.g., produce) can only be sold to tourists in the domestic market because of insufficient export capability and international marketing expertise.

The question of small island economy viability has received a growing interest in the last 20 years. Currently, heightened attention has reemerged due to (1) attention paid by the World Bank, (2) creation of the Commonwealth Vulnerability Index, (3) persistent calls of differential treatment to small states within the World Trade Organization, and (4) formation of a Consultative Group of Small Economies within the negotiations framework of the Free Trade Area of the Americas (Crowards, 2002).

However, a consistent conceptualization or measurement of smallness does not exist. The question of size first emerged in the economics of international trade defining a small country as a price taker in the international global markets. More recently parameters for determining what constitutes a small state emerged related to population, land area, and GDP. For example, Demas (1965), Kuznets (1960) and Streeten (1993) focused on population criteria. Conventional

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literature has addressed size from the perspective of insufficiency: population, labor, diseconomies of scale, entrepreneurship and capital, and resources in general. The inherent restrictions related to market size, resources, labor and capital force small countries to look to the global economy in order to achieve economies of scale in the production of exports. Increasing exports means becoming more vulnerable to the global market cycle. This view consigns a small island to economic weakness and marginality.

If smallness of scale is a problem, how is it to be surmounted? Some scholars, such as Lewis (1955) saw the opportunity of defeating manufacturing scale problems through specialization where trade can substitute for domestic production. Demas (1965) saw the solution in aggregation through regionalism to create economies of scale. Others saw the solution in breaking free from the capitalist world system (Bryden, 1973; Perez, 1974; Turner, 1976; Britton, 1982).

Until recently, the role of tourism for the growth of small island economies was viewed with skepticism. Lewis (1955) excluded tourism from the specialization of growth-enhancing-tradable-services. Demas (1965) considered tourism too unreliable. Wilkinson (1987), Fagance (1999) and Rao (2002) questioned whether tourism was a wise strategy to overcome the problems attributable to an island's small size due to high opportunity costs to national economies. If tourism was pursued, some contended that the only kind of tourism acceptable is the sustainable paradigm which limits the development of traditional large scale tourism and excludes the possible contribution to broader socio economic development (Wilkinson, 1989).

This paper's main premise is that basing any strategy on a supply perspective is not conducive to keeping these small economies competitive in the era of globalization. It proposes a perspective based on demand to enhance the tourist product value. It begins to answer three questions: (1) Why is tourism relevant for small island economies?; (2) What are the weaknesses in the supply perspective for these economies? and (3) Why is a demand perspective more appropriate for small island economies in the globalization era?

This paper does not discuss what constitutes a small island economy because there is substantial treatment of this subject in the literature (Easterly & Kraay, 2000; Lanza & Pigliaru, 2000; Armstrong & Read, 2001; Wint, 2003; Liou, 2002; Crowards, 2002). This study uses the Caribbean region as a proxy for small island economies¹. Caribbean states are small in population, land

area and total income and has a long history in tourism development (Schwartz, 1999) generating 3.6% of the world's international tourism receipts and attracting nearly 2.4% of the total global arrivals. The Caribbean was sixth in the global ranking behind the United States, France, Italy, Spain and the United Kingdom (WTO, 2002). Furthermore, in 2001, the Caribbean was the largest regional supplier of tourism for developing countries worldwide.

2. Tourism and opportunities to small islands

The most effective means for achieving economic performance in a country has been debated with arguments focusing on comparative and competitive advantage, the degree of openness of an economy, and the hurdles of economic scale and scope affecting economic performance. Oyewole (2001) argued that specialization in services has a strong positive impact on economic performance and he predicted that countries specializing in tourism would do well. This was similar to Latimer's (1985) and Modeste's (1995) findings that economic development in small islands is positively affected by growth in tourism. Despite what the critics say, several small islands now use tourism development as a growth strategy to achieve greater economic and development performance.

It is intuitive that small size could hamper economic performance yet tourism has become an important vehicle to overcome size constraints (Conlin & Baum, 1995; Apostolopoulos & Gayle, 2002; Baum, Hagen-Grant, Joliffe, Lambert & Sigurjonsson, 2000). Many have described the disadvantages that small size imposes on the growth process because of the difficulty of achieving sufficient economies of scale in a wide variety of basic economic activities (Read, 2001). The inherent restrictions related to market size, resources, labor and capital force small countries to look to the global economy in order to achieve economies of scale in the production of exports. Increasing exports in a world of open trade means that the size of the national market becomes less relevant than the size of regional or global market.

In comparison to many developing countries, small islands exhibit an enviable record of economic performance (Easterly & Kraay, 2000; Lanza & Pigliaru, 2000; and World Bank, 2002). This income advantage reflects a productivity advantage and demonstrates that small islands can leverage returns to scale in global markets.

(footnote continued)

¹For the purpose of this study, the term Caribbean encompasses all the 30 members of the Caribbean Tourism Organization (CTO): Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Bermuda, Bonaire, British Virgin Islands, Cayman Islands, Cuba, Curaçao, Dominica, Grenada, Guadeloupe/St. Barts/St. Martin, Guyana, Haiti, Jamaica, Martinique, Montserrat, Puerto Rico, St.

Eustatius, St. Kitts and Nevis, St. Lucia, St. Maarten, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, and United States Virgin Islands.

Evidence suggests that many small countries are wealthier, grow at the same pace, and have higher productivity levels than large states (Easterly & Kraay, 2000). Vanegas and Croes (2003) suggested a strong positive relationship between tourism and economic performance in Aruba. Consequently, it is argued that country size variables have little influence on differences in growth rates.

Confirmed by Latin America and the Caribbean, countries with less than one million inhabitants have outperformed countries with more than 10 million inhabitants by more than five times during a period spanning from 1980 to 2000 (Escaith, 2001). Some of the success is due to specialization patterns in the Caribbean. Service-based economies (such as Barbados, Antigua and Barbuda, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, the Bahamas, the British Virgin Islands, and the Cayman Islands) have shown a more robust response to globalization (Read, 2004) than goods based economies.

In most cases of small—yet fast growing—countries, the predominant productive sector has been the service sector, which includes tourism (Ocampo, 2002; Armstrong & Read, 2001). Largeness is no guarantee of prosperity and smallness of scale is not fatal to prosperity. This empirical record suggests that either that the alleged constraints of small size are not disabling or that these small entities have found ways to overcome such constraints.

Tourism provides advantages in overcoming smallness in three ways. First, it provides the volume to overcome insufficient market demand enabling greater efficiency and providing economies of scale for more goods and services which decreases the unit costs of production.

Second, it increases competition by encouraging new entrants in the market place, which provides a positive impact on the price level of goods and services. The presence of start-up companies democratizes the market structure and prevents market dominance. For example, in Aruba, new entrants more than doubled from 1940 in 1987 to 4442 in 1999, a 229% increase, according to the Central Bureau of Statistics of Aruba in 2000. These new entrants with the aid of competitive global pressures quickly learn to accommodate risk-taking. They use diffusion of technology and entrepreneurial learning in order to improve quality of their products and services.

This competitive environment deters rent-seeking activities and the corruption often associated with protected environments. Facing constant international competition, the local tourist industry in any particular Caribbean country is forced to improve its standards. For example, a local hotel belonging to a world-class chain must maintain the same high international

standards wherever it operates, and in turn, will impose high standards on local suppliers and employees. In terms of both products and services, the local market must raise and maintain its standards. This makes the domestic market work effectively, promoting efficiency in the entire economy (Bhagwati & Srinivasan, 1979; Krueger, 1980).

Third, tourism, by providing scale and competition together with greater consumer choice and trade openness, can raise the standard of living and thus improve the quality of life in a small country. Mullen (1993) asserted that trade openness stimulates economic growth which, in turn, meets the basic needs of the population.

Tourism accounts for more than 10% of the GDP of the best economic performers in the Caribbean, such as the Bahamas, Barbados and Antigua and Barbuda, according to a study of Ramkissoon (2002), which measured the average change over a 25 year period from 1975 to 2000 in per capita GDP. In the case of the worst performers, the size of this sector was negligible. One study found significant correlation between tourism growth and economic growth in a study of 29 Caribbean countries (Grassl, 2002 as cited in Jayawardena & Ranajeasingh, 2003).

Jayawardena and Ranajeasingh (2003) found evidence that small islands have no disadvantage in specializing in tourism spurred by lower net capita earnings. Vanegas and Croes (2003) found in Aruba that the net value of tourism receipts was nearly 84%. Tourism, offers the best chance for development in terms of creating growth and employment, generating foreign exchange and reducing poverty. These findings contradict the conventional literature which suggests that tourism increases the price level in the destination for the local population (Goeldner & Ritchie, 2003; Lundberg, 1974).

Openness and international competition also may generate substantial volatility in tourism earnings. This statement is confirmed by Sinclair and Tsegaye (1990), who found that tourism increased instability in the export sectors of small, open economies. The ensuing instability could cause adverse effects in the destination, such as a decrease in income, jobs, and investments. Thus, the positive effects caused by openness could be jeopardized by this instability. Easterly and Kraay (2000) found, however, that ‘...the positive growth effect of openness ...is 2.5 times larger than the negative effect of small states’ greater output volatility.’

In a recent empirical study to determine tourism volatility in the Caribbean, Maloney and Montes Rojas (2001) concluded that tourism revenues are from twice to five times as stable as goods revenues. This suggests that tourism revenues are likely to be less volatile than these commodities.

3. The relevance of tourism to the Caribbean

Caribbean states face common constraints of size, such as vulnerability to external shocks and natural disasters yet the Caribbean has performed relatively well in economic terms. Throughout the period of 1970–2000, the Caribbean region has had higher per capita growth than Latin America.

The region's positive performance is due to reliance on tourism for growth. In 2001, the Caribbean received over 16 million tourists (82% of the total inbound tourism to Canada and Mexico) and has more tourists than South America and Central America. In terms of receipts, Caribbean tourism generated US \$16 billion in foreign exchange, representing 20%, 150%, 200%, 120% and 700% of international receipts accrued respectively to the United States, Canada, Mexico, South America and Central America (WTO, 2002). The Caribbean is the second largest recipient of inbound tourism and international receipts in the Americas.

Tourism has made important contributions to the economies of the Caribbean for decades and has become the dominant economic sector for most of the countries. Tourism is the single largest earner of foreign exchange in 16 of the 30 countries in the region. For example, in the Bahamas, the US Virgin Islands, the Cayman Islands, and St. Lucia, the share of tourism in GDP is 60% or more (WTO, 2002). In 2001, tourism and travel were estimated to generate US\$ 34.3 billion of economic activity, producing 16.5% of regional GDP and 15.5% of total employment (WTTC, 2002).

One in every seven jobs in the Caribbean is supported by tourism, and by 2012 this ratio is expected to increase to one in every six jobs, which would provide for nearly 3 million jobs. According to an estimated growth rate of arrivals of 4.8% World Travel and Tourism Council (WTTC) estimates, tourism economic activity in the Caribbean by 2012 will expand to nearly US\$ 75 billion and generate tourism receipts in excess of US\$ 40 billion (WTTC, 2002).

4. Challenges on the horizon

The recent performance of the Caribbean, however, has raised significant concerns. Here, Caribbean performance is compared with other regions in the world based on average growth rates of arrivals and receipts. The methodology of the study consists of (1) growth rates estimation is used through the estimation of Eqs. (1) and (2):

$$\text{TARR}_{jt} = \gamma e^{\delta \text{Time}}, \quad (1)$$

$$\text{TAE}_{jt} = \eta e^{\theta \text{Time}}. \quad (2)$$

After taking logs on both sides, Eqs. (1) and (2) can be specified as

$$\log \text{TARR}_{jt} = \gamma + \delta \text{Time}, \quad (3)$$

$$\log \text{TAE}_{jt} = \eta + \theta \text{Time}, \quad (4)$$

where TARR_{jt} and TAE_{jt} are tourist arrivals and tourist receipts for the j region in period t respectively, and δ and θ multiplied by 100 give values of the average annual growth rates. Secondly, the study estimates the elasticities.

Third, the volatility of tourism receipts is estimated. This volatility is captured by the standard deviation of tourism receipts growth. This volatility is specified as

$$\text{Volatility} = s/y, \quad (5)$$

where,

$$s = \sqrt{\sigma_x^2} = \sqrt{\sum_{i=1}^N p_i [x_i - E(x)]^2}.$$

The study estimated Eqs. (3) and (4) by the ordinary least squares. The study used the time series from 1986 to 2001 because of the availability and quality of data available for that time period. Furthermore, this period covers a full business cycle, from the boom of the late 1980s, through the recession of the early 1990s, to the recovery of the mid-1990s. For each region, the study collected the annual international receipts and international arrivals from WTO yearbooks. Next, the study unified the estimations behind the results to produce a single set of acceptable measures. For lack of a reliable data series, the study did not include the number of visitor days.

The study included a country if complete data were available yielding an analysis of 32 countries (see Table 1). Each sample included five countries, except the Middle East where only two countries were analyzed. To study performance across time two periods were examined: from 1986 to 1993 and from 1994 to 2001.

Table 2 presents a summary of the results. Foreign exchange income from tourism in the Caribbean (7.13%) increased at rates lower than the world average (7.85%), Europe (7.2%), Americas (7.8%), Middle East (8.5%), Africa (9.4%) and East Asia and the Pacific (10.9%). The Caribbean clearly lost global market share.

However, average growth for the Caribbean (4.5%) grew faster than Europe (4%) and the Americas (3.4%), but it grew slower than the world average (4.7%), South Asia (5%), Africa (7.3%), East Asia and the Pacific (7.9%), and the Middle East (8.7%). It appears that the Caribbean region did not perform well in comparison with the rest of the world, either in terms of growth in international receipts or arrivals.

The performance of the regions measured in terms of elasticity indicates a highly fluctuating situation. In the

Table 1
Selected indicators by country, 2001

Country	Region	Area sq km in thousands	Population in millions	International receipts in US \$ millions	GDP2001 in US \$ billions	Share of tourism receipts of GDP ^a
Kenya	Africa	580.4	30.70	308	11.4	2.70
Mauritius	Africa	2.0	1.20	625	4.5	13.89
Seychelles	Africa	0.5	0.08	113	0.57	19.84
Tanzania	Africa	0.9	34.40	725	9.3	7.80
Tunisia	Africa	163.6	9.70	1605	20.0	8.03
Argentina	Americas	2800.0	37.50	2547	268.8	0.95
Brazil	Americas	8500.0	172.40	3701	509.0	0.73
Costa Rica	Americas	51.1	3.90	1278	16.4	7.79
Mexico	Americas	2000.0	99.40	8401	623.9	1.35
United States	Americas	9600.0	285.30	72,295	10,100	0.72
Aruba	Caribbean	0.2	0.09	890	2.1	42.38
Barbados	Caribbean	0.4	0.27	687	2.8	24.54
Dominican Republic	Caribbean	48.7	8.50	2681	21.2	12.65
Jamaica	Caribbean	11.0	2.60	1277	7.8	16.37
Haiti	Caribbean	27.8	8.10	54	3.7	1.46
Cyprus	Europe	9.3	0.76	1981	9.1	21.77
Greece	Europe	132.0	10.60	9121	117.2	7.78
Malta	Europe	0.3	0.40	579	3.6	16.08
Portugal	Europe	92.0	10.00	5479	109.8	4.99
Spain	Europe	506.0	41.10	32,873	581.8	5.65
Indonesia	East Asia	1900.0	209.00	5411	141.3	3.83
Fiji	East Asia	18.3	0.82	217	1.7	12.76
Korea, South	East Asia	99.3	47.30	6373	427.2	1.49
Malaysia	East Asia	329.8	23.80	6374	88.0	7.24
Singapore	East Asia	0.6	4.10	5081	84.9	5.98
Egypt	Middle East	1000.0	65.20	3800	95.8	3.97
Jordan	Middle East	89.2	5.00	700	8.8	7.95
India	South Asia	3300.0	1.00	3042	481.4	0.63
Myanmar	South Asia	676.6	48.30	45	2.86	6.36
Nepal	South Asia	147.2	23.60	140	5.6	2.50
Pakistan	South Asia	796.1	141.50	92	58.6	0.16
Sri Lanka	South Asia	65.6	18.70	211	15.7	1.34

Source: World Bank and WTO.

^aEstimated from the published statistics of the World Bank and WTO.

Table 2
Performance results per region on a global scale, 1986–2001

Region	Average annual growth receipts			Average annual growth arrivals			Elasticity			Volatility ^a		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Africa	9.43	10.72	8.14	7.30	9.21	5.39	1.21	0.94	1.3	5.6	6.9	2.6
Americas	7.79	11.60	3.98	3.41	4.82	2.00	0.66	2.21	1.94	3.8	2.4	5.4
Caribbean	7.13	8.44	5.81	4.53	5.51	3.55	1.54	1.59	1.67	3	2.5	2.5
Europe	7.20	9.97	4.44	4.03	4.82	3.24	1.55	1.83	0.91	7	6.1	4.7
Middle East	8.49	7.95	9.03	8.69	8.11	9.27	0.99	0.67	0.77	12.85	12.04	5.9
East Asia and the Pacific	10.86	15.93	5.79	7.91	9.51	6.31	1.17	1.46	0.38	11.63	4.7	6.6
South Asia	6.92	6.41	7.43	4.95	3.49	6.40	1.27	1.62	0.89	7.2	6.5	5.2
World	7.85	11.03	4.66	4.66	5.53	3.79	1.52	1.81	0.89	6.4	3.6	4.3

(1) = 1986–2001, (2) = 1986–1993, and (3) = 1994–2001.

Source: World Tourism Organization.

^aVolatility is measured by the standard deviation in percentage points of receipts growth.

first period, only Europe and the Caribbean performed better than the world average. In the second period the only two regions performing higher than the world

average were the Americas and Europe. The last period showed an important improvement in performance as four regions performed better than the world average:

Americas, the Caribbean, Africa and Europe in that order. The Americas as a region was more than twice as effective in foreign exchange generation as the world average.

The Caribbean enjoyed the highest elasticity arrivals receipts under any of the periods reviewed, and it was outperformed consistently by Europe in the first and second periods, and the Americas during the second and third period. The Caribbean, however, experienced a stable tourism income growth during each of the three periods under consideration, and it became the most stable region in the whole world by surpassing the world average by a factor greater than two. The elasticity coefficient of 1.54 during 1986–2001 raises a warning flag as foreign exchange receipts have been rising proportionally more slowly than arrivals. This dent in the effectiveness of tourism in generating more foreign exchange should be a concern for tourism strategic policy makers.

This mixed picture of Caribbean performance is complicated further by the high concentration of tourism growth in the region. The WTO statistics show that more than 70% of the increase in the region during that same time span came from five countries: Aruba, Cuba, Dominican Republic, Jamaica and Puerto Rico (see Fig. 1). This suggests a high concentration of tourism dollars in only a few countries. For every 10 tourism dollars spent in the region, seven dollars went to these five countries, leaving three dollars for the remaining 24 countries comprising the Caribbean, (according to the WTO geographical definition). If Belize, Guyana and Suriname (these countries are listed by the WTO under Central America and South America, respectively) were added to the list of countries usually considered as the Caribbean region, then the region's performance would have decreased even further. This may well be the reason why the region is so diversified in terms of economic development, with average income per capita ranging from US\$ 481 in Haiti to US\$15,954 in the Bahamas at a ratio of 1:30 (World Bank, 2002).

Caribbean tourism appears to be losing its value enhancing capability. Ceara-Hatton (1998) identified a decrease in efficiency in generating foreign exchange as compared to the world average and he suggested that the increase in tourism income is a result of a higher volume of arrivals rather than prices, which suggests a decreasing value of the Caribbean tourism product. Maloney and Montes Rojas (2001) also confirmed these findings, and they suggested that the negative trends are a consequence of the growing presence of "all inclusive" packages and increasing competition.

The reality of the Caribbean indicates a product being consumed by relatively more buyers who are spending less. Thus, it appears that more resources are being allocated for product manufacturing of tourism goods

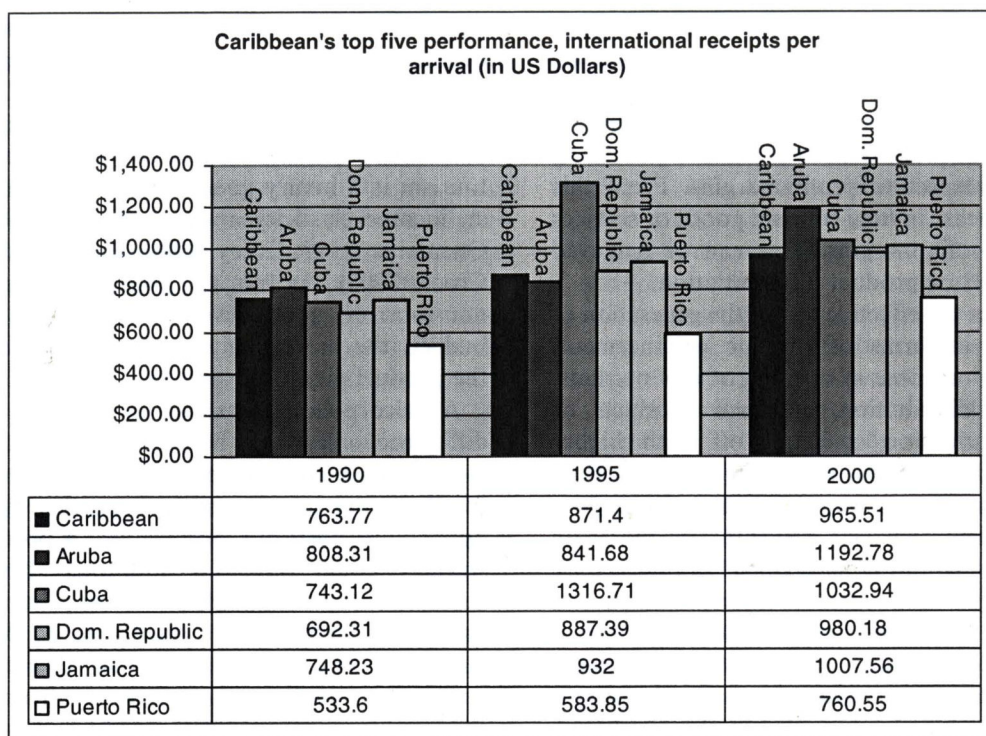
in the Caribbean increasing their opportunity costs. This finding may be particularly relevant for the Caribbean as it makes policy choices regarding the most promising strategy for enhancing the tourism value.

For example in 2001, Puerto Rico discovered that its marketing dollar was producing increasingly fewer benefits over the preceding 17 years (Fajardo, 2002). In 1985, every one million dollars that Puerto Rico spent on marketing and promotional efforts generated US \$72 million in tourist expenditures. In 2001, that same dollar amount produced only US \$65 million in tourist expenditures. Tourism marketing organizations increasingly are held accountable for the effectiveness of marketing programs through objective measurement, which shows specific economic and social impacts, such as job creation, tax revenues, and investments.

To further compound the marketing problems, Ceara-Hatton (1998) and Bryan (2001), have identified some important "negative externalities" present in the industry today including devaluation of the destination, unemployment and underemployment, growing presence of prostitution and drugs, increased violence and ecological imbalances, and negative health concerns. Further a rise in competition with an eventual opening of Cuba to American tourists should be a matter of concern to the Caribbean states. Today, tourism is the number one export of Cuba and it surpasses both sugar and hard currency in remittances. In 2001, Cuba—with a total of 37,000 hotel rooms—received 1.8 million visitors and 1.9 billion in gross income. By 2010, Cuba expects to receive 7 million tourists, which would require a total of 185,500 rooms. With such a large potential rival for US tourism waiting in the wings, it would behoove the countries of the region to assess empirically the impact of this possibility and plan accordingly (Brundenius, 2002; Henthorne & Miller, 2003).

5. From factors input to value enhancement

Empirical data demonstrates that specializing in tourism is a successful development strategy for the Caribbean. Due to symptoms of exhaustion of the Caribbean product, an adjustment of the strategy may be needed. The strategy would refocus on demand offering numerous advantages including: (1) bringing the Caribbean closer to customers; (2) enabling the region to identify the several product price elasticities in order to assist in a pricing strategy of maximizing the net economic surplus appropriated by the destinations; (3) providing the region with more control of the market making it a more unique product; and (4) strengthening the resource planning orientation to include quality enhancement, refurbishment and regeneration and upgrading. These strategies will enhance the value of the Caribbean product.



Source: WTO

Fig. 1. Caribbean's top five performers as expressed in international receipts per arrival (in US Dollars).

For centuries, scholars have debated whether value is supply or demand generated (Dobb, 1973). This paper take the demand side approach and as such shall focus on that area. The demand school asserts that value is created in the opposite sequence—at the end of the chain—by the actual demand of the customer. Typically, the tourism literature reflects the sequence of supply and demand. There is a perceived direct link between economic development and the prospects of tourism supply. This link may relate to the complex nature of the production process of tourism and the process of its delivery. Basically, the product cannot be stored and must be consumed on site. Its appeal relies on the attractiveness of natural and man-built attractions, and it consists of many components.

Based on the sustainable development model, Wilkinson (1989) suggested a new approach to tourism in small islands. Deriding the mass tourism strategy adopted by many island countries as “folly,” he embraced an alternative approach, which is based on locally controlled, small scale, community participation, environment and heritage preservation, and comprehensive government involvement.

This strategy clearly restricts business opportunities. Many small and locally controlled firms lack “in-house” the capacity (in terms of financial, technological, and marketing resources), experience and technical expertise

needed to survive in a highly competitive tourism world. Wilkinson's view poses a danger of having a closed system that ultimately may harm a small entity, such as an island, which must participate in the global system in order to survive. In addition, it is not clear how these small insular economies can enhance the value of their products if their economies are not linked in a meaningful way to the global system.

The sustainable development approach suggests that too many visits are to blame for all that is wrong at a destination level. Such reasoning is faulty. The question is how can the value of the product be enhanced to create wealth? The shift in emphasis to value enhancement creates a new set of challenges for an organization. Porter (1990) contended that a strategy of differentiation, uniqueness and reduction of elasticity, and the creation of a niche market based on segmentation were supreme, asserting that relational assets (i.e., buyers, suppliers, potential competitors, and existing competitors) are the most efficient competitive strategy to create value and improve performance.

Creating value is one of the core components of any business strategy. In essence, value is determined by the organization and implementation of discrete activities by firms and destinations. These activities are related to the efficient conversion of resources into products and their effective delivery to the market. These activities

encompass tourism vision, product design and development, product distribution, marketing strategy and the raising of capital. Value is created through the implementation of these activities and is measured by the degree that consolidated costs are either stabilizing or decreasing in respect to profit margins. From this perspective an increase in final tourism goods or services should increase profit margins. This can be achieved through lower costs or product differentiation.

Value determines the effectiveness of the generation of foreign exchange in terms of revenue enhancement, which could be an outcome of opening of new markets, new channels of distribution, and new products or services. Any destination is better off with higher revenues generated from value enhancement rather than from greater volume (more arrivals) or higher inflation.

But why is a new approach needed? The literature indicates that small countries specializing in tourism are among the fastest growing countries in the world (Lanza & Pigliaru, 2000). The condition for successful specialization is the low elasticity of substitution between tourism goods and non-tourism goods in the origin countries. Tourism based economies in the Caribbean have shown a more robust response to globalization (Ocampo, 2002). Ocampo found, however, that even though the Caribbean has shown great economic dynamism because of tourism, it has not gotten the maximum advantage from its product potential.

The reason may be the region's lack of sufficient knowledge of the tourism market and the factors affecting the demand for tourism. There is a critical need for such knowledge in order to understand competitive performance, to develop reliable forecasting, and to design an effective business strategy (Croes, 2003). Viewed from a value enhancement perspective, tourism demand has a critical impact on the development of destination and product specific market shares. In a recent study, Smeral (2003) found that tourism services have become relatively more expensive than other goods. He attributed this trend to the two special characteristics of tourism production and consumption. First, there is the perishable nature of the production. Second, there is an element of inseparability in the production. The linkage of production and consumption both temporarily and spatially restricts rationalization opportunities. In Smeral's view, the costs in the tourism business rise over time because productivity in tourism jobs lags productivity in manufacturing. The underlying assumption in his reasoning is that nominal wages equalize across sectors so that lower productivity manifests itself as relatively more rapid increases in prices.

These reasons alone, however, cannot explain the steady increase in tourism prices. The comparatively inelastic reaction of supply to rapidly changing demand affects the adoption of productivity advances and

innovative potential in the tourism industry. Consequently, tourism products can extract higher "rents" because of scarcity. Higher prices also could be attributed, however, to the special consumption pattern of tourism services. There is growing evidence that tourism is a luxury good because tourism demand has an income elasticity above 1 (Clarke, 1978; Metzgen-Quemarez, 1989; Carey, 1991; Vanegas & Croes, 2000; Croes, 2000). As tourism products compete less with non-tourism goods within an individual's limited budget, the more likely price increases can overcome the productivity disadvantage.

A price policy of extracting a "rent" to offset the difference will work best in a high quality, unique tourism base environment. Under such a condition, a small country can overcome this deficit by facing lower opportunity costs of specialization. A profit maximizing strategy could have an additional benefit for the destination because high prices may be interpreted as signals of high quality. According to Keane (1996), charging premium prices is an incentive to deter components in the tourist industry from cheating on the quality of the tourist product. Keane identified Bermuda as a high-quality destination that charges premium prices in order to undertake quality maintenance of its hotel inventory and to increase its reputation to attract more customers. This is an important feature under conditions of imperfect information.

If Keane is correct, then the costs of foregoing growth effects from knowledge accumulation in manufacturing and other "progressive sectors" (according to endogenous growth theory) may be outweighed by trade through importing productivity growth overseas. The record in the Caribbean seems to bear out the competitive advantage in tourism.

6. A value enhancement approach: a four pronged strategy

The Caribbean region faces several serious challenges. It receives more customers, but they spend less than before. The region also faces rising production costs by firms in the tourism industry. In addition, the countries of the Caribbean seem to suffer because much of the value generated by its tourism industry does not remain within the country, but rather is transferred to intermediaries (oligopsony). These challenges are compounded by a competitive strategy based on price, which will have deleterious consequences for the competitiveness of the Caribbean region. One obvious solution for these issues is that demand dictates supply in terms that the tourist activities must accommodate the modifications that come from the demand side.

Because value is demand driven, a strategy focusing on value will require a greater knowledge of customers' tastes and preferences. Such an approach implies a process inversion in which the final consumer will be the starting point for organizing the production chain all the way through the raw material stage. This approach enhances value by creating products with the highest entry barriers, i.e. access to niche markets, financial services, research, design and marketing facilities.

Supply, however, may fail to adapt to demand because of certain rigidities. For example, productive factors, particularly environmental and artistic resources, cannot always be replicated. Moreover, the supply of the tourist goods cannot be stored—its consumption cannot be separated from its production. Investments under these conditions can become true sunk costs because they have no alternative uses.

Most firms in the Caribbean are small in nature (Bryan, 2001). Enhancing profitability of their production by reducing costs requires integrated operating methods in order to achieve economies of scale. This is extremely challenging for small and medium size firms. The only way for these firms to deal with globalization processes and to maintain competitiveness is by adopting a strategy that emphasizes product quality and differentiation. Firms that develop the unique quality of their product have the best chance to overcome the challenges of rising costs, substitutability, and the constant changes in the economic environment triggered by globalization.

Creating unique experiences is based on the premise that the quality of services provided should not only exceed those of the competition, but also should be consistent. Consistency requires the nurturing of relational assets among the suppliers and government on the one hand (Woolcock, 2001). These assets facilitate joint and collaborative actions which is typical of the tourism system. Facilitating communication among suppliers makes them more familiar to each other, and creates mutual trust. Trust has important economic effects, because it makes cooperation easier, straightforward, and it lowers transaction costs in economic life. On the other hand, consistency also requires a constant flow of investments. If financing is unavailable locally, the ability to support these investments can represent a serious comparative disadvantage in many Caribbean countries.

These relational assets rely on shared objectives, distributional fairness and common threat. The concept of uniqueness as espoused by quality delivery captures all three aspects. For example, a program designed to facilitate the arrival of tourists by promising "Thirty Minutes to the Beach" can align all relevant stakeholders (immigration and customs personnel, airport personnel, cab drivers, police, hotel personnel, and the

host community in general) in undertaking a common effort to achieve a specific objective.

Manufacturing this unique experience as end product is difficult. It calls for maintaining the quality of a tourist product reproduction. It also requires balancing growth with environmental protection. Government intervention is needed to control the various negative externalities caused by tourist activities. The short-term drive to maximize profits may affect the destination's ability to support greater inflows of tourists, thereby jeopardizing the destination's attractiveness (the Butler cycle effect). Furthermore, firms have an incentive to extract premium prices under conditions of information asymmetry, which typically exist at tourist destinations (Crane and Jackson, 2000). To prevent the market from destroying itself, however, requires offering quality goods and services, and attracting repeat customers (Keane, 1996).

What can government do to increase economic efficiency and welfare, reduce the likelihood of rent-seeking behavior and increase the ability of firms to adapt to changing circumstances? To promote markets, the government should create a performance-based reward structure that provides strong growth-oriented incentives and promote policies of product differentiation and barriers to entry of new firms. Product differentiation reduces potential competition among sellers and, thus, stimulates cooperation. Control of entry by the government can stimulate quality and enable existing firms to continue to charge premium prices.

The government should create policies to support education—particularly hospitality and tourism education (including language skills)—which provides an intellectual infrastructure that facilitates innovation and value enhancement. It is notable that the Caribbean, despite its reputation as a tourist destination, lacks reputable hospitality and tourism educational institutions of internationally recognized caliber. Because there are many small businesses, governments should promote centers offering services ranging from identifying new products to providing research and development for firms that have no facilities of their own. The government should manage marketing spillovers to promote a reputation for that particular destination in such a way that small firms also can benefit without making their own expenditures in this regard.

Small firms lack the incentive to promote their own reputation so they depend on the brand of the destination. The quality of the brand of a destination, however, depends on the input of these many small businesses. Coordination of these inputs is a strategic asset in and of itself, and it requires both the willingness and the capacity to induce business behavior to promote cooperation within the industry. It is critical to establish

institutions capable of promoting regular consultations among industry members and generating incentives for businesses to develop long-term relationships that withstand the temptations for short term gains of cheating (Keane, 1996). Regulating quality of the tourist product and providing incentives for suppliers are critical to maintain quality. The government must understand that rewards are crucial in the encouragement of cooperation. The government can create programs involving contests in which the best performing businesses will get a reward either in the form of tax breaks or access to favorable financing. These contests obviously must be transparent in the application of the rules.

With respect to raising capital for tourism projects, governments should explore more sophisticated methods of financing. Certain tourist infrastructure projects that produce a revenue stream, such as airports with landing fees, may be financed on attractive terms in international capital markets provided the transaction is structured properly. For example, in the late 1990s, the government of Aruba financed the expansion of its international airport by the sale of airport revenue bonds to US investors. The structure of the transaction allowed the government of Aruba to finance the expansion without paying for the project out of government funds and without providing a mortgage for the airport property. The transaction had the added benefit of introducing Aruba to the international markets and laying the foundation for the government to subsequently obtain a favorable sovereign credit rating.

In other words, the government should move away from the planning paradigm (resource allocation and ordering) as the basis for the promotion of economic development as espoused by Demas (1965) and others. Governments should play a more entrepreneurial role by combining technological and marketing knowledge. They also should intervene to assist all players in the tourism industry in areas where they cannot help themselves, such as raising capital, monitoring the quality of the tourism product, and promoting greater coordination.

In addition to promoting quality, government should promote returns on scale. The strategy of regionalism could become a powerful tool to assist governments in promoting greater competitiveness if regionalism is rethought and reconfigured to meet today's challenges. A new regionalism, however, would represent a departure from the conventional regionalism of Holder (1996), Bryan (2001), and others. The conventional approach is premised on coordinating efforts for regional marketing and other functional areas of cooperation with a minimal presence of national and regional suppliers (carriers and tour operators).

A new regionalism, however, would require the leveraging of regional firms to form alliances in order

to give market power to the local tourist firms. In order for regionalism to remain a viable tool for development, it must shift away from the conventional approach of pooling financial resources to market one large region (i.e., the Caribbean). The new regionalism must be based on greater knowledge of the complex consumption trends as well as the technologies and business models needed to respond to these trends. Name recognition and branding of individual destinations are relatively well developed. Supporting name branding through regional promotion and marketing was useful at one time, but such a strategy is no longer sufficient today because of the new exigencies of globalization.

The crucial question about rent enhancing activities in the Caribbean rests on increased competition under conditions of incomplete and imperfect information. Imperfect information may create opportunities for intermediaries to extract excessive rents in the exchange process. The general preference of buyers for more certainty may create an oligopoly favoring the intermediaries.

Supply providers may become less innovative if they cannot cope with demand uncertainty. Indeed, any venture becomes risky under this condition. The easy solution is to transfer this risk to the intermediaries, but in doing so the supplier's capacity will be held hostage by the intermediary. Forward sales of capacity through commitments are made at contract prices that surrender much of the potential profits through consumer surplus. Consequently, the intermediaries may have an upper-hand in the price market. This market structure creates powerful incentives to under-price the product. This situation in the Caribbean was alluded to by Maloney and Montes Rojas (2001).

A different kind of regionalism is needed to address this problem of value transfer. Value transfer captures a share of nearly 25% of the total value of the tourist product (Buhalis, 2000). This share accrues almost completely to the intermediary. The development of one regional online intermediary to serve the interests of the domestic industry may be a positive step. The cost of tourism reproduction and distribution may be minimal if the means of distribution is the Internet. The CTO could provide valuable assistance in its creation because it has the technological expertise that appears to be lacking in individual countries (Bryan, 2001). The application of information technology is crucial in this respect because it helps to identify niches and to facilitate the joint production of services.

The new regionalism also can be a powerful catalyst in facilitating coordination among regional firms and in reducing the cost of information necessary to form alliances among regional firms. To gain legitimacy in the region, the new regionalism must meet two conditions. First it must represent all interests in the Caribbean and avoid any perception of favoring the English speaking

countries. True diversity should guide the representatives of this new regionalism. Second, this new regionalism should fund its own activities. One way to create a funding system is to charge a 50 US cents surcharge for passengers arriving at Caribbean airports. This surcharge can be included in the tickets of the passengers and therefore will be disbursed by the carriers to the organization (e.g., the CTO). This amount will generate in the first year alone nearly US \$10 million, about three times higher the current core budget of the CTO. Of course, all Caribbean countries would have to subscribe to this surcharge before it could be implemented.

This strategy will take time and efforts to achieve, but if implemented can contribute to economic growth and well-being. It will work best in a high-quality environment. Tourism policy must avoid the mass tourism strategy of producing an interchangeable tourism product. By being unique with a specific and irreproducible resource base and distinctive competencies, tourist destinations can position themselves at a relatively higher price level. They will be able to avoid the disadvantages of service economies (Copeland, 1991; Keane, 1996; Mazzanti, 2002), and become sustainable in the long term.

7. Conclusions

The article addressed why tourism is an important developmental tool in the context of small island economies. The Caribbean in general has outperformed several regions in significant ways. Recently, however, signs of stagnation and even deterioration have arisen. This may be the result of the region's failure to cope with the new exigencies of globalization. Part of the problem is that the Caribbean has relied upon a supply perspective of tourism based on an outdated planning paradigm of resource allocation and ordering and has neglected the process of value enhancement.

The article suggested that a demand approach is a more effective way to respond to the pressures of globalization and proposed a four pronged strategy to reverse value depletion in the Caribbean. This demand focused strategy consists of: (1) bringing the Caribbean closer to customers; (2) enabling the region to identify the several product price elasticities; (3) providing the region with more control of the market making it a more unique product; and (4) strengthening the resource planning orientation to include quality enhancement, refurbishment and regeneration and upgrading.

The implementation of new tourism strategies based on a demand focused approach and supported by empirical analysis could provide improved market knowledge to small island economies, which, in turn, could use it to achieve and sustain competitiveness in the

global tourism industry. Tourist destinations must understand the complex consumption trends and technologies needed to respond to these trends in order to enhance product differentiation create access to niche markets, and to adjust business models. Because coordination is crucial in the reproduction of the tourist experience, small island economies have a comparative advantage in tourism than larger entities in terms of their greater sense of national solidarity, their relatively greater ability to adapt rapidly to change, and greater flexibility in administration (Streeten, 1993). Actually, the record indicates that the Caribbean can be successful where economies of scale are not an issue.

If small island economies choose to ignore such an approach, however, they run the risk of squandering their potential for further economic development by continued reliance on ad hoc and anecdotal information in the formulation of their tourism policy. The implication is clear in terms of the creation of a research agenda based on a new development contract framed in terms of value enhancement for the Caribbean in this millennium.

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